ECONOMICS

Analyse the impact of changes in the global economy on Australia's economic performance.

The global economy refers to the increasing links between individual economies which has resulted in changes in one economy having a 'ripple effect' on others. Australia has embraced the globalisation process and pursued policies to integrate its economy with those around the world. As a result, global economic changes can have massive impacts, both positive and negative, on Australia's economic performance. Through Australia's external stability this relationship with the global economy can be observed.

The transmission of economic conditions from one country to another has been made more immediate since the process of globalisation. This is characterised by the shift from individual, national economies to a world economy through a process of increasing integration, developing markets and commercial exchanges across nations. Major factors causing globalisation include financial deregulation, trade liberalisation, growth of international investment and technology as well as improvements in communications and transportation. Lifting controls on foreign currency markets, the internationalisation of the labour market as well as the growth of TNC's are also global impacts that have affected Australia's economic activity.

Financial deregulation and trade liberalisation have been the most influential changes in the global economy. Reduced protection has been instrumental in opening up the Australian economy to global trade flows. In the 1970's Australia's average tariff level was 36%, today over half of all imports are tariff free. Australia is committed to increasing free trade as a member of the WTO and APEC and has signed many bilateral trade agreements to allow the benefits of global integration to be appreciated. As a result of these changes, the size, pattern and direction of Australia's trade and investment have altered dramatically over the past 2 decades. The economy has seen a major decrease in trade with Britain and the rest of Europe in favour of increased trade with Japan and more recently China and ASEAN nations.

Imports from China have expanded nearly 600% since 1985, whilst exports to Europe have decreased from 35% to just 10% since the 1960's. These changes reflect global influences such as the formation of the EU trading bloc, the strong growth of Japan and China and associated demand for minerals as well as the recent development of NIC's such as Thailand in the ASEAN region. Financial trends have seen massive increases in both direct and portfolio investment due to deregulation, the removal of foreign exchange restrictions, improved communications, growth of TNC's, floating of the $A and world economic growth.

Due to these changing economic factors, Australia has become increasingly linked to the global economy, including the major economic contributors such as the US and China. The size and strength of this global economy can be calculated by gross world product, a measure of the aggregate value of goods and services produced worldwide each year, in 2009 this was estimated to be $58.15 trillion. Variations in world economic activity are known as the international business cycle. As Australia continues to be involved in this economic cycle, its performance becomes increasingly reliant upon the world economy.

This 'ripple effect' is demonstrated by the emergence of China and it's associated demand for minerals which has helped fuel Australia's strong economic performance prior to the GFC and during the recovery. China's current growth rate of 10.3%, makes the nation set to achieve its goal of quadrupling its 2000 level of GDP by 2020, ahead of schedule. In 2040, the Chinese economy is predicted to reach $123 trillion, nearly three times the economic output of the entire globe in 2000. Further, China's share of global GDP will be 40%, compared to the United States 14% in the next 3 decades. Australia is determined to increase its global links to ensure the economic benefits China can provide will be received. An Australia-China free trade agreement has been proposed which could boost Australia's economy by $24 billion in just 10 years. China's rapid growth and development will surely continue to play a major role in Australia's future economic performance.

In comparison, the GFC had a detrimental 'ripple effect' on economies around the world. For Australia the slowing of the world economy impacted significantly on the economy's performance as exports and US foreign investment levels fell whilst major trading partners including China experienced a slow down, causing the domestic economy to slow. A recession was narrowly avoided due to Australia's strong economic management and global involvement in initiatives such the synchronisation of macroeconomic policies as initiated by the "Washington Consensus". The economy's performance is now improving strongly due to the upturn in the global economy.

Most recently there have been concerns that the world and Chinese economies could slow again due to debt problems in European nations such as Greece and Italy. Although Australia is no longer heavily involved with these nations, its place in the global economy has resulted in the effects of this economic uncertainty being felt domestically. The RBA has kept interest rates on hold despite inflation slightly exceeding the target range as the possibility and strength of a European slowdown is still being observed. There are also fears that inflationary pressures could force Chinese authorities to raise their interest rates, which would reduce China's rapid growth. This would have a 'ripple effect' on Australia, slowing the economy by negatively affecting export prices and volumes.

To analyse the relationship between Australia and the global economy external stability should be considered. As Australia has become increasingly integrated with the global economy, it must be able to meet its long term financial commitments to the rest of the world. This is essential for the maintenance of economic performance as Australia is a small economy with a relatively narrow export base and high level of net external liabilities. This makes the nation more vulnerable to changes in investor perceptions of its economic performance. If Australia was feared to be unstable, a depreciation of the currency, withdrawal of investment funds, higher interest rates and slower economic growth would be likely to occur.

To prevent this Australia must gain a sustainable position on the current account, ensure an acceptable level of foreign debt whilst maintaining international confidence in the economy by stabilising the value of the $A. In recent times Australia has recorded persistently high CAD's as a result of import, export and net income factors. During the GFC the CAD fell to a low of $4.6 billion in March 2009 mainly due to decreased demand for imports and export resilience from strong demand for minerals. The CAD has been increasing recently however, reaching $16.5b in March 2010. This occurred due to the deterioration of Australia's TOT caused by the decline in mineral prices following the global slowdown and increased foreign investment and imports due to Australia's strong recovery. High CAD's have led to concerns that they will make Australia more vulnerable to adverse conditions in the global economy. Further, consistently high CADs put the nation at risk of excessive foreign debt which can have major implications for the domestic and world economy, as evidenced recently with the European debt crisis.

Volatility in the exchange rate also has a significant impact on external stability. Exchange rates provide a direct link between Australia and the global economy as all trade and financial relationships are mediated through the exchange of currencies. Since the floating of the $A in 1983 Australia has become increasingly global minded, exposing the currency to increased risks of fluctuations. A volatile dollar affects the balance of payments as it influences Australia's international competitiveness as well as the size and servicing costs of foreign debt. It is also an indicator of international confidence in the economy and its management and so if investors view Australia's economic fundamentals as unstable the value of the dollar is likely to fall.

By embracing the globalisation process and successfully pursuing policies to integrate its economy with nations around the world, Australia has exposed itself to the global business cycle, resulting in associated influences on the economy's performance. The global economy's strength is predicted to soar, with increasing interactions between individual economies, further deregulation, trade liberalisation and integration in the future. Australia’s external stability will continue to represent this growing relationship between Australia and the world, upon which the performance of the domestic economy is now increasingly dependent.